In re Omnitrition International Inc. Securities Litigation, 1994 WL 655897 (1994)

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Jeffrey A. Babener, principal attorney in the Portland, Oregon, law firm Babener & Associates, and editor of www.mlmlegal.com, represents many of the leading direct selling companies in the United States and abroad.

In re Omnitrition International Inc. Securities Litigation, 1994 WL 655897 (1994)

Case: In re Omnitrition International Inc. Securities Litigation (1994)

Subject Category: Securities

Agency Involved: Private Civil Suit

Court: US District Court, N.D. California.

Case Synopsis: The District Court was asked to decide on summary judgment if the Omnitrition program was a security subject to regulation under federal securities laws.

Legal Issue: Is the Omnitrition program a security subject to regulation under federal securities laws?

Court Ruling: The District Court granted summary judgment in favor of Omnitrition and dismissed the claim. The court found that Omnitrition had adopted programs that previous court decisions had found to be conclusive evidence that an opportunity was not a security. The adoption of these programs, a requirement that distributors sell to a number of retail customers each month, a requirement that 70% of inventory be sold before allowing reorders, and a prohibition on downline bonuses unless the distributor makes certain retail sales, adequately demonstrated that Omnitrition was not a security subject to regulation under federal security laws.

Practical Importance to Business of MLM/Direct Sales/Direct Selling/Network Marketing/Party Plan/Multilevel Marketing: The adoption of certain sales policies can prevent the claim that a company is an illegal pyramid scheme. But this specific case was appealed, and the holding was modified to require a showing that the policies were actually effective in their goal, not simply that they existed.

In re Omnitrition International Inc. Securities Litigation, 1994 WL 655897 (1994) (Not reported):

The District Court granted summary judgment in favor of Omnitrition and dismissed the claim. The court found that Omnitrition had adopted programs that previous court decisions had found to be conclusive evidence that an opportunity was not a security. The adoption of these programs, a requirement that distributors sell to a number of retail customers each month, a requirement that 70% of inventory be sold before allowing reorders, and a prohibition on downline bonuses unless the distributor makes certain retail sales, adequately demonstrated that Omnitrition was not a security subject to regulation under federal security laws.

Not Reported in F.Supp.

Fed. Sec. L. Rep. P 98,425

(Cite as: 1994 WL 655897 (N.D.Cal.))

In re OMNITRITION INTERNATIONAL, INC. SECURITIES LITIGATION.

MDL No. 965.

No. C 92-4133 SBA.

United States District Court,

N.D. California.

July 25, 1994.

ARMSTRONG, District Judge.

*1 Plaintiffs, former distributors for defendant Omnitrition International, Inc. ("Omnitrition"), bring the above-captioned matter alleging that the defendants violated federal securities laws, the civil RICO statute, and state fraud laws in the creation, promotion and marketing of Omnitrition and its distributorships. On May 11, 1994, defendants Omnitrition, Jim Fobair, Roger Daley and Charles Ragus filed the instant motion for summary judgment or, alternatively, summary adjudication of issues. Defendant Jerry Rubin has filed a joinder in this motion. Plaintiffs have filed a counter-motion for summary adjudication of certain issues. After having reviewed and considered all of the papers

submitted in connection with these motions, as well as the arguments of the parties, and being fully informed, the Court finds that the defendants' motion for summary judgment should be granted and plaintiffs' counter-motion should be denied.

BACKGROUND

An individual joins Omnitrition by filling out an application. (Declaration of Jarrett C. Lambert in Supp. of Defs.' Mot. for Summ.J. or, Alternatively, Summ. Adjudication [Lambert Decl.] ¶ 4). Participants were originally required to pay a filing fee, however, Omnitrition later eliminated that requirement. (Id.)

Once the application is approved, an individual becomes a participant in the program. Participants are called Independent Marketing Agents ("IMA"). (Id.) IMAs begin their association with Omnitrition as ground level sellers of products, called distributors. A distributor is entitled to purchase Omnitrition products at a 20% discount and sell them to the general public. (Id. at ¶ 10). There are no obligations to purchase or sell products. (Id. at ¶ 6). Distributors are not entitled to receive any bonuses, overrides, or other royalties for having a "downline" (i.e., having a network of distributors subordinate to an IMA). (Id. at ¶ 12; Ex. A, at 12-13).

An IMA can also become a supervisor. One can become the lowest level supervisor, the bronze supervisor, by selling $2,000.00 worth of products in a month, or $1,000.00 in two consecutive months. A supervisor is entitled to a 30% discount in Omnitrition products. Moreover, a bronze supervisor receives a 10% retail bonus based upon future sales of their downline, and receives a 4% royalty [FN1] on 3 generations of qualified supervisors. (Id. Ex. A, at 8, 12- 13).

There are also silver, gold, and diamond supervisors. (Id. Ex. A, 12-13). At these levels, the bonuses and overrides are calculated on the retail sales of certain distributors in their downlines. (Id. Ex. A, 10-13). However, in order to qualify for these rewards, all supervisors must also certify that they have made ten retail sales to ten customers per month. (Id.)

Plaintiffs are individuals who obtained distributorships with Omnitrition between 1989 and 1992. Plaintiffs contend that Omnitrition is a pyramid scheme. (Amended Complaint, ¶ 24) Omnitrition allegedly created and markets a line of health food products. (Amended Complaint, ¶ 23). However, plaintiffs maintain that Omnitrition did not engage in or encourage retail sale of these products. Rather, plaintiffs maintain Omnitrition actively recruited distributors of the products, who would in turn be encouraged to recruit more distributors. (Amended Complaint, ¶ 24).

DISCUSSION

A. Summary Judgment

*2 Summary judgment is appropriate under Fed.R.Civ.P. 56(b) where there exists no genuine issues of material fact and as a matter of law the moving party is entitled to win. Celotex Corp. v. Catrett, 477 U.S.

317, 322 (1986). For purposes of the motion, the court must construe the opposing party's papers liberally; resolving all ambiguities and drawing all reasonable inferences in their favor. Patrick v. LeFevre, 475 F.2d 153 (2nd Cir.1984). That being the case, a factual dispute is to be considered genuine only if the non-moving party can offer "concrete evidence" such that a reasonable jury could return a verdict in their favor. Anderson v. Liberty Lobby, 477 U.S. 242, 256 (1986). The burden on the moving party may be discharged by pointing out to the district court that there is an absence of evidence to support the opposing party's claim. Celotex at 325.

B. Whether Omnitrition is an Illegal Pyramid Sales Scheme

1. Definition of an Illegal Pyramid Sales Scheme

The Federal Trade Commission (FTC) has formulated a legal definition of an illegal pyramid sales scheme which has been adopted by this Court in Nguyen v. Fundamerica, Inc., 1990 WL 165247 (N.D.Cal. Aug. 21, 1990) (Patel, J.). According to the FTC and the Nguyen court, a pyramid sales scheme is a business in which

a participant pays money to the company or its representatives and in return receives (1) the right to sell products, and (2) the right to earn rewards for recruiting other participants into the scheme that are unrelated to product sales.

Id. (citing Federal Trade Commission v. Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975), aff'd sub nom, Turner v. FTC, 580 F.2d 701 (D.C.Cir.1978)); In re Amway, 93 P.T.C. 618 (1979). At the hearing on the instant motions, plaintiffs conceded that this definition is the appropriate standard for determining whether a business is an illegal pyramid sales scheme.

Based upon the structure of the Omnitrition system, it is apparent that Omnitrition does not meet the definition of an illegal pyramid scheme. As a threshold matter, the participants in the company, IMAs, do not pay money to obtain sales and/or recruiting rights. As previously mentioned, there is no charge for joining the company. Once the application is approved, the participant obtains the right to buy Omnitrition products at a 20% discount, and the right to sell Omnitrition products. (Lambert Decl. ¶ 4, Ex. A, at 12- 13).

More significantly, an IMA does not obtain the right to earn rewards for recruiting other participants into the scheme that are unrelated to product sales. A participant in Omnitrition does not receive any payment or reward for merely recruiting others into the program. (Lambert Decl. ¶ 12, Ex. A, at 12- 13). These new recruits must make retail sales. [FN2] If the recruiter has achieved a sufficient sales volume to qualify for overrides and/or bonuses, and the new recruits make retail sales, the recruiter receives a payment from Omnitrition based upon a percentage of the retail sales of his downline. Thus, unlike a scheme that falls within the Nguyen standard, Omnitrition provides rewards for recruiting participants that are directly related to product sales. In fact, the reward is conditional on product sales, and the amount of the award is based upon the amount of product sales that occur. [FN3]

*3 Plaintiffs offer no competent or admissible evidence to refute defendants' position. In fact, plaintiffs fail to address the Nguyen and FTC test in their papers, though, as previously mentioned, plaintiffs conceded at the hearing that the Nguyen test is the appropriate standard for determining whether a business is, in fact, an illegal pyramid sales scheme.

2. The Amway Safeguards

In its opinion in In re Amway Corporation, 93 F.T.C. 618 (1979), the FTC found that certain safeguards employed by a direct marketing company are evidence that a business is not an illegal pyramid sales scheme under the FTC standard relied upon by the Nguyen court.

The Amway Corporation sold a variety of home care, car care, and personal care products, as well as vitamin and food supplements. Each Amway distributor had the right to sell Amway products to consumers, to sponsor new Amway distributors and to sell products to his or her sponsored distributors. Amway distributors earned income from retail sales of products, performance bonuses based on a point system and percentage of Amway products purchased for resale; in addition, for those who chose to sponsor other distributors, income could be earned on the total sales volume of the sponsor's personal distributor group. Id. at 646.

Amway required that distributors resell 70% of the purchases they made each month. Moreover, Amway had a "ten customer" rule which precluded distributors from receiving a performance bonus unless they could certify sales to ten different retail customers each month. Finally, Amway agreed to refund up to 90% of any unused marketable products from a distributor. Id.

The Administrative Law Judge (ALJ), which the FTC was reviewing on appeal, found that these safeguards are evidence that Amway was not a pyramid scheme. The ALJ held that the characteristics of a pyramid scheme are "compensation for recruiting regardless of consumer sales" by means of "headhunting fees" or "commissions on mandatory inventory purchases by the recruits known as 'inventory loading' ". Id. at 667.

The FTC upheld the decision, finding that an Amway distributor:

is not required to pay a headhunting fee or buy a large amount of inventory to become an Amway distributor. The only purchase a new distributor is required to make is a $15.60 Sales Kit, which contains Amway literature and sales aids; no profit is made in the sale of this Kit, and the purchase price may be refunded if the distributor decides to leave the business. Thus a sponsoring distributor receives nothing from the mere act of sponsoring. It is only when the newly recruited distributor begins making wholesale purchases from his sponsor and sales to consumers, that the supervisor begins to earn money from his recruits efforts ...

The ALJ found that the buy-back rule, the 70 percent rule, and the ten- customer rule are enforced, and that they serve to prevent inventory loading and encourage retailing. (Citation omitted.) Given these

facts, the Amway plan is significantly different from the pyramid plans condemned in Koscot, Ger-Ro-Mar, and Holiday Magic. Specifically, the Amway plan is not a plan where participants purchase the right to earn profits by recruiting other participants, who themselves are interested in recruitment fees rather than retail sales.

*4 Id. at 715-17.

At least one California state appellate court has adopted the Amway test. In Bounds v. Figurettes, Inc., 135 Cal.App.3d 1, 21-22 (1982), the court reviewed the Amway decision and found that defendants, though they sold products in addition to recruiting distributors, was a pyramid scheme, as the defendants did not have the Amway safeguards. Specifically, the Figurettes defendants had a headhunting fee, did not make product sales a precondition of receiving bonuses, did not have a buy-back provision, and did not require a substantial percentage of products be sold to consumers at retail. Id.

Defendants maintain, and plaintiffs do not dispute, that Omnitrition has implemented safeguards identical to those employed by the Amway Corporation. Omnitrition has no head-hunting fee. (Lambert Decl., ¶ 6). Omnitrition IMAs must certify on each product form that at least 70% of the products previously purchased had been sold. (Id. at ¶ 15). To receive any bonuses or royalties for sales by one's downline, a supervisor must first certify that he or she made at least ten retail sales to ten different retail consumers each month. (Id. at ¶ 13). Also, if an IMA cannot or chooses not to sell products he or she has purchased, Omnitrition will provide a 90% refund for the cost of non- consumable products if returned within twelve months, and within three months for consumable products. (Id. at ¶ 7).

Plaintiffs contend, however, that the Amway safeguards are insufficient to insure that Omnitrition is not a pyramid scheme. Specifically, plaintiffs contend that the safeguards do not insure retail sales or prevent inventory loading. [FN4] Moreover, plaintiffs insist that Omnitrition does not effectively enforce the 70% and ten-customer rules.

Plaintiffs offer no competent or admissible evidence to support their positions. Rather, plaintiffs rely on the alleged Declaration of Dr. Itamar Simonson, an associate professor of marketing at the Graduate School of Business, Stanford University. (Alleged Decl. of Dr. Itamar Simonson in Opp'n to Defs.' Mot. for Summ.J. [Alleged Simonson Decl.] ¶ 1). However, the declaration presented to the Court was not signed by Dr. Simonson and was consequently stricken from the record. [FN5]

Even if the Court were to consider the purported declaration of Dr. Simonson, the Court would find it wholly unpersuasive. In relevant part, Dr. Simonson allegedly testified that only $10 million of Omnitrition's approximately $51 million in sales for 1993 were the result of retail sales. [FN6] Dr. Simonson allegedly reached this $10 million figure by reviewing an analysis performed by an unidentified individual. [FN7] (Alleged Simonson Decl. ¶ 25, at 20-22). This individual allegedly reviewed a group of Form 1025s, the forms which Omnitrition supervisors must submit to demonstrate the requisite monthly ten retail sales to ten customers to render them eligible for overrides and bonuses.

The individual considered a total of 169 forms consisting of the third form from each month of a file encompassing the period November of 1992 to March of 1994. The individual then allegedly estimated that 1,400 to 1,500 forms would be submitted to Omnitrition in a month, and calculated the average payment made to supervisors based on these forms, $579.00, and multiplied that figure by 1,500 forms, resulting in a total retail sales figure of $868,500.00 per month or approximately $10 million per year. (Id. at 21)

*5 Dr. Simonson, however, does not explain what conclusions should be drawn from the difference between his determination that Omnitrition's retail sales totaled $10 million and Omnitrition's total sales of approximately $51.5 million. [FN8]

Defendants identify several faults with the professor's analysis. For example, the professor assumes, without any apparent basis, that only 1500 Form 1025s are received each month. [FN9] As defendants note, the plaintiffs and the professor had in their possession Form 1025s for the period in question; thus, they simply could have counted the average number of forms received in one month. (Defs.' Reply Mem. in Supp. of Mot. for Summ.J. at 13). This raises a more fundamental question concerning plaintiffs' reasons for utilizing such a small sample size as well as the resulting accuracy of the survey. Neither Dr. Simonson nor the plaintiffs explain how its survey is representative of Omnitrition's total sales.

Moreover, it is not apparent that the basic assumption underlying Dr. Simonson's conclusions--that Form 1025s are an appropriate measure of the total retail sales--is valid. As defendants note, and plaintiffs do not dispute, Form 1025s reflect only a portion of all retail sales. For example, a supervisor who makes fifty retail sales in a month is only required to report ten of those sales on a Form 1025. Moreover, as the penalty for failing to file Form 1025s is the withholding of bonuses and overrides, there is no apparent incentive for distributors, who are not eligible for bonuses or overrides, to submit these forms; thus, these sales would not be accounted for in Dr. Simonson's analysis. (See Lambert Decl. ¶ 12, Ex. 12-13) [FN10] Finally, Form 1025s do not reflect products purchased by distributors for personal consumption. Clearly, a sale of Omnitrition products to an individual who uses them is a retail sale.

More significantly, as defendants noted in their papers and at the hearing, if Dr. Simonson's analysis were correct, there would be some evidence that participants in Omnitrition engaged in inventory loading. In other words, if IMAs bought Omnitrition products to advance in the company's hierarchy, the IMAs would possess unwanted products. (Defs.Sep. Statement of Facts, ¶¶ 45, 48, 50). However, defendants maintain, and plaintiffs do not dispute, that there is no evidence that any Omnitrition participant purchased products they did not want for their own use or were unable to sell. There is no evidence before the Court which demonstrates that Omnitrition's approximately $51.5 million in sales are attributable to anything other than retail sales. Tellingly, there in fact is no evidence that any Omnitrition IMA lost money through participation in the company.

Dr. Simonson also allegedly testified that Omnitrition failed to adequately enforce their ten-customer rule. (Alleged Simonson Decl. ¶ 25, at 21-22). However, Dr. Simonson's position was unsupported by any

competent evidence. Dr. Simonson allegedly testified, without any apparent basis, that the punishments exacted for failing to comply with the ten-customer rule were not significant. Defendants maintain that withholding bonuses and overrides is a significant punishment, as evidenced by the testimony of Joseph Beasy, who had a check of almost $9,000.00 withheld pending resolution of a discrepancy in his Form 1025. (Burns Decl.Ex. D, at 102-105).

*6 Moreover, the Amway Corporation employed the same ten-customer rule, but utilized a weaker enforcement mechanism. Specifically, Amway required a distributor to submit proof to his sponsor and direct supervisor concerning Form 1025s. In re Amway Corporation, 93 F.T.C. at 716. By contrast, Omnitrition checked Form 1025s itself, through the use of random verifications. (Burns Decl.Ex. K, at 113-114). Mr. Rick Williams, a data entry operator for Omnitrition's Retail Sales and Compliance Department, testified that he and other Omnitrition employees made telephone calls to customers listed on Form 1025s to verify that retail sales occurred and to encourage repeat sales. (See Burns Decl., Ex. O, at 10-28).

Plaintiffs suggest that an insubstantial percentage of Form 1025s were ever reviewed and verified by Omnitrition. (Alleged Simonson Decl., ¶ 25, at 21- 22). However, plaintiffs have failed to provide competent or admissible evidence in support of this conclusion. By contrast, Mr. Rick Williams testified that the Omnitrition Retail Sales and Compliance Department made approximately one thousand calls to verify Form 1025s each month. (Burns Decl., Ex. O, at 23-24). Plaintiffs fail to forward any standard by which the Court could conclude that these enforcement efforts were not substantial.

In addition, as previously discussed, there is no evidence that Omnitrition's ten-customer rule, and therefore its enforcement mechanism, was ineffective. There is no evidence that any participant possessed unwanted products, or, more significantly, that any IMA ever lost money through participation in Omnitrition. Finally, as previously mentioned, the FTC found the Amway safeguards to be significant because they encouraged, rather than insured, retail sales. Plaintiffs have offered no competent or admissible evidence that Omnitrition's safeguards failed to do either. [FN11]

Plaintiffs have not forwarded any competent evidentiary support for their assertion that Omnitrition is an illegal pyramid scheme. As the preceding discussion demonstrates, even if it did not strike the purported Simonson Declaration and instead treated it as competent evidence, the Court would find the declaration wholly unpersuasive and without merit.

Accordingly, under the Nguyen standard, and after considering Omnitrition's use of the identical safeguards employed by the Amway Corporation, the Court finds that Omnitrition does not conform to the legal definition of an illegal pyramid sales scheme. [FN12]

C. Whether Omnitrition Distributorships Are Securities Pursuant to § 12 of the Securities Act of 1933 and § 10(b) of the Securities Exchange Act of 1934

Defendants maintain that Omnitrition distributorship are not securities pursuant to Section 12 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934. To establish that a transaction involves securities, the Court must determine whether the scheme involves an investment of money in a common enterprise with profits derived solely from the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

*7 The Ninth Circuit has interpreted the Howey requirement that a participant's profits be generated "solely from the efforts of others," to mean "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 (9th Cir.1973).

In Glenn Turner, "investors" who purchased an "educational course" were allowed to collect commissions from others when these "investors" brought these recruits to recruitment seminars and were eventually signed onto the program. The trial court found that the benefit of earning these commissions "is in all respects the significant one." Glenn Turner, 474 F.2d at 478. The Court held that

In this case, Dare's source of income is from selling the Adventures and the Plan. The purchaser is sold the idea that he will get a fixed part of the proceeds of the sale. In essence, to get that share, he invests three things: his money, his efforts to find purchasers and bring them to the meetings, and whatever it costs him to create an illusion of his own affluence. He invests them in Dare's get-rich-quick scheme.... In our view, the scheme is no less an investment contract merely because he contributes some effort as well as money to get into it.

Glenn Turner, 474 F.2d at 481. To hold otherwise, the Court believed, would allow individuals to evade the law by adding a requirement to their schemes that the buyer contribute a modicum of effort. Id.

Defendants allege that all participants in Omnitrition, even those who receive compensation based upon the products sales of their downlines, must engage in significant individual effort in order to obtain any benefits from being a distributor or supervisor. (See Lambert Decl.Ex. A). All participants must engage in retail sales. (Id.) As previously mentioned, even at the upper levels of the Omnitrition hierarchy, supervisors must make at least ten retail sales to ten customers in each month in order to qualify for bonuses and overrides. (Id.) Moreover, several Omnitrition IMAs, including plaintiffs Shawn Webster and Robert Ligon, testified that they spend twenty to twenty-five hours per week on their Omnitrition businesses. (Burns Decl.Ex. N, at 75, Ex. J, at 105-07). Other Omnitrition participants testified that they worked as many as fifteen hours a day building up their distributorships. (Burns Decl.Ex. D, at 95, 126-28; Ex. E, at 54-56; Ex. I, at 108, 131-34; Ex. L, at 89-90). Each of these distributors also testified that they knew that their distributorships would necessitate hard work on their part. (Id.)

Given the testimony of these Omnitrition participants, including both named plaintiffs in this action, and the complete absence of any evidence to contradict this testimony, it is quite evident that Omnitrition distributorships do not depend primarily upon the efforts of others and Omnitrition participants are

"not the passive investor(s) intended to be concerned by the federal security laws." Bitter v. Hoby's International, Inc., 498 F.2d 183, 185 (9th Cir.1974).

*8 Accordingly, given the holding of Howey and its progeny, as well as the testimony of the named plaintiffs in this action, Omnitrition distributorships are not securities for purposes of § 12 of the Securities Act of 1933 and the Securities Exchange Act of 1934.

D. Whether Defendants' Statements and Alleged Omissions Are Actionable Pursuant to Section 12(2) of the Securities Act of 1933 and § 10(b) of the Securities Exchange Act of 1934

Defendants maintain that even if Omnitrition distributorships can be properly characterized as securities, none of the statements allegedly made by the defendants, as set out in paragraph 37 and 38 of the amended complaint, are actionable under the security laws. Defendants contend that these statements are merely opinions and "puffing" and thus are not actionable.

In general, statements of opinion are not actionable. See Presidio Enterprises, Inc. v. Warner Bros. Distrib. Corp., 784 F.2d 674, 679 (5th Cir.1986). Opinions as to the success of companies or products, including statements that a product will be a "blow-out winner," In re Technologies Securities Litigation, 804 F.Supp. 1368, 1372 (D.Colo.1992), or that a company is a "market leader" and "well-positioned" for growth, In re Caere Corporation Securities Litigation, 837 F.Supp. 1054, 1057 (N.D.Cal.1993), or that a stock is so "red hot" that the investor cannot lose, Rothstein v. Reynolds & Co., 359 F.Supp. 109, 113 (N.D.Ill.1973), should be understood by reasonable investors as "mere puffing." Storage Technologies, 804 F.Supp. at 1372.

However, the Ninth Circuit, in In re Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir.1989), cert. denied 496 U.S. 943 (1990), has set out a three part test for determining when statements of opinion may be actionable in securities fraud cases.

A projection or statement of belief contains at least three implicit factual assertions: 1) that the statement is genuinely believed, 2) that there is a reasonable basis for that belief, and 3) that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement. A projection or statement of belief may be actionable to the extent that one of these implied factual assertions is inaccurate.

Id.

Plaintiffs have challenged every statement on the ground that Omnitrition is a pyramid scheme that was destined to collapse, and that each defendant knew this to be true. However, as previously discussed, Omnitrition does not meet the legal definition of an illegal pyramid sales scheme. [FN13] Accordingly, plaintiffs' claims that Omnitrition is inherently destined to collapse are unsupportable. [FN14]

Moreover, defendants have each submitted declarations in which they maintain that they genuinely believed and continue to believe that every statement they made is true. (Daley Decl. ¶ 3, 4, 6; Decl. of James Fobair ¶ 3, 4, 6; Decl. of Charles Ragus ¶ 3, 4, 6). Defendants have therefore met the first prong of the Apple test.

*9 Each defendant also testified that he had a reasonable basis for believing the statements to be true. For example, defendant Fobair maintains that he believes Omnitrition is not a pyramid scheme based upon his emphasizing to Omnitrition participants the importance of hard work to build and maintain a distributorship, as well as Omnitrition's emphasis on retail sales and its reliance on its retail sales rules. (Decl. of James Fobair, ¶ 4, 5). Defendants Daley and Ragus have testified similarly. (Decl. of Charles Ragus, ¶¶ 4, 5; Daley Decl. ¶¶ 4, 5) Plaintiffs have not forwarded any evidence or argument suggesting that defendants' bases for believing their statements to be true were unreasonable, thus, defendants have met the second prong of the Apple test.

Finally, plaintiffs have not forwarded any evidence suggesting that any defendant was aware of undisclosed facts tending to seriously undermine the accuracy of each statement. Thus, the third prong of the Apple test is met. [FN15]

E. Plaintiffs' Claims pursuant to § 10(b) off the Securities Exchange Act of 1934

1. Whether Defendants Acted with the Requisite Scienter

Scienter is a necessary element in an action for damages under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. § 240:10b-5. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); In re Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir.1989), cert. denied 496 U.S. 943 (1990). Scienter may be established by proof of either actual knowledge of falsity or recklessness. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568 (9th Cir.1990), cert. denied, 499 U.S. 976 (1991).

In a footnote, plaintiffs maintain that "all of the Omnitrition promotional literature, audiotapes, videotapes and transcripts of conference calls raise the triable issue of fact with respect to the scienter of the defendants, i.e. their purportedly 'honest and reasonable belief' that the program they are marketing is not a pyramid scheme." (Pl.s' Opp'n to Defs.' Mot. for Summ. J. at 21 n. 10). However, plaintiffs fail to designate or identify what specifically in these hundreds of pages of material creates this triable issue of fact. [FN16]

Without proof of a motive for defendant's participation in an alleged fraud, plaintiffs "bear a heavy burden in defeating summary judgment with inferences drawn from circumstantial evidence." In re Software Toolworks, 789 F.Supp. 1489, 1499 (N.D.Cal.1992).

Given their failure to provide any evidence of scienter, plaintiffs have not sustained their burden with respect to this element of their Section 10(b) claims. Therefore, even if Omnitrition distributorships

could be properly characterized as securities, and even if the defendants' alleged statements and omissions were actionable, defendants are entitled to summary judgment on plaintiffs' § 10(b) claims.

2. Whether Plaintiff Has Provided Evidence of Loss Causation or Damages

*10 To recover under Section 10(b), plaintiffs must prove that defendants' purported misconduct "cause[d] the loss for which they seek to recover." McGonigle v. Combs, 968 F.2d 810, 821 (9th Cir.), cert. dismissed, 113 S.Ct. 399 (1992). Such loss causation is also a prerequisite to recover for common law fraud. Bastian v. Petren Resources Corp., 892 F.2d 680, 683-86 (7th Cir.), cert denied 496 U.S. 906 (1990).

Defendants maintain that there is no evidence that their actions caused anyone financial harm. Plaintiffs have failed to address this issue.

Significantly, defendants contend that there is no evidence that any Omnitrition IMA lost money through participation in the company. Plaintiffs fail to provide any evidence to dispute this position. In fact, named plaintiff Shawn Webster testified that he sold or personally consumed all of the products he purchased, and that as a result he either made a profit or broke even. (Burns Decl.Ex. N., at 360). [FN17] Ron Cashman--another IMA whose downline Webster was in--testified that Webster said he made money as an Omnitrition distributor. (Burns Decl. Ex. E. at 150). [FN18]

3. Plaintiffs' Secondary Liability and Conspiracy Claims for Section 10(b)

The Supreme Court, in Central Bank of Denver v. First Interstate Bank of Denver, --- U.S. ----, 1994 U.S. Lexis 3120 (April 19, 1994), held that plaintiffs may not pursue Rule 10b-5 claims for aiding and abetting.

Defendants maintain that plaintiffs' conspiracy claims must fail as well, as there is no "significant probative evidence" of "an agreement to participate in an unlawful act." Vaughn v. Teledyne, Inc., 628 F.2d 1214, 1220 (9th Cir.1980); Alfus v. Pyramid Technology Corp., 745 F.Supp. 1511, 1520 (N.D.Cal.1990). Plaintiffs have not identified any evidence in the record demonstrating the existence of such an agreement, especially in light of Omnitrition's not falling within the Nguyen definition of a pyramid scheme. Moreover, defendants Jim Fobair, Roger Daley, and Charles Ragus have each submitted declarations in which they maintain they did not enter into an agreement to deceive or mislead Omnitrition IMAs. (Fobair Decl. ¶ 8, Daley Decl. ¶ 8, Ragus Decl. ¶ 9)

F. Plaintiffs' Claims Pursuant to 18 U.S.C. §§ 1962(c) and (d) [RICO]

1. Whether Plaintiffs Have Proof to Support Their Allegations of Defendants' Engaging in RICO Predicate Acts

To be held liable under the RICO statute, defendants must have conducted the affairs of the enterprise "through a pattern of racketeering activity." 18 U.S.C. § 1962(c). To show this pattern, the RICO statute

requires two or more predicate acts. 18 U.S.C. § 1961(5). Plaintiffs maintain that defendants engaged in mail fraud, wire fraud and securities fraud.

Mail fraud or wire fraud is demonstrated if plaintiffs can show that defendants 1) formed a scheme or artifice to defraud, 2) used the mails or wires in furtherance of the scheme, and 3) did so with the specific intent to deceive or defraud. California Architectural Building Products, 818 F.2d 1466, 1469 (9th Cir.1987). However, the requirement of specific intent is met by showing the existence of a scheme that was reasonably intended to deceive the ordinary person, and this intention is determined by looking to the scheme itself. United States v. Green, 745 F.2d 1205, 1207 (9th Cir.1984), cert. denied, 474 U.S. 925 (1985).

*11 Plaintiffs maintain that since they have proven Omnitrition is a pyramid scheme, they need not prove specific intent. However, as previously discussed, plaintiffs have failed to demonstrate or otherwise establish a triable issue of fact concerning whether Omnitrition is a pyramid scheme. As there is otherwise no evidence of specific intent on the part of the defendants to defraud anyone, plaintiffs' RICO claims are fatally deficient.

2. Whether There is a Legally Cognizable RICO Enterprise

Section 1962(c) allows private parties to file suit against "persons" associated with an "enterprise" who participate in the enterprise's affairs through a pattern of racketeering activity. See 18 U.S.C. § 1962(c). Under section 1962(c), RICO plaintiffs must allege the existence of a RICO enterprise that has "an ascertainable structure which is distinct from the racketeering activity itself." Colegrove v. Price Waterhouse, 1992 WL 435799 at 4 (N.D.Cal.1992).

In their amended complaint, plaintiffs allege that Omnitrition was conceived and operated by defendants as an illegal pyramid scheme. (Amended Complaint., ¶ 31). Plaintiffs have failed to allege that the defendants have engaged in any activity separate and apart from the alleged pattern of racketeering acts in the course of the conduct of the enterprise, or that the participants joined Omnitrition for any purpose other than promoting Omnitrition's business activities. [FN19]

As plaintiffs have failed to identify a cognizable RICO enterprise, plaintiffs' § 1962(c) and (d) claims are also legally deficient.

G. Plaintiffs' State Claims

Plaintiffs allege claims for common law fraud and deceit, the elements of which are a misrepresentation of material fact, knowledge of falsity, intent to deceive, justifiable reliance, and resulting damage. Cicone v. URS Corp., 183 Cal.App.3d 194, 200 (1986). Plaintiffs have provided no evidence as to any of these elements, most notably damages, reliance, intent to deceive, or a misrepresentation of fact.

Plaintiffs' remaining state law claims are for false advertising and unfair business practices. Both of these claims are premised on the allegation that the statements allegedly made by defendants were false and misleading. (Amended Complaint, ¶ 90, 92). As discussed in the analysis of plaintiffs' § 10(b) and § 12 claims, plaintiffs have failed to provide any evidence to support a finding that any statements made by defendants were false and misleading.

CONCLUSION

For the reasons stated above,

IT IS HEREBY ORDERED THAT

1. Defendants' motion for summary judgment is GRANTED.

2. Plaintiff's counter-motion for summary adjudication of certain issues is DENIED.

3. Defendant Jerry Rubin's unopposed joinder of defendants' motion for summary judgment is GRANTED.

IT IS SO ORDERED.

JUDGMENT

Pursuant to an Order of this Court granting defendants Omnitrition International, Inc., Jim Fobair, Roger Daley and Charles Ragus' motion for summary judgment, which was joined by defendant Jerry Rubin,

*12 IT IS HEREBY ORDERED that FINAL JUDGMENT be entered in favor of defendants Omnitrition International, Inc., Jim Fobair, Roger Daley, Charles Ragus, and Jerry Rubin.

IT IS SO ORDERED.

FN1. This royalty is referred to as an "override".

FN2. At the hearing, plaintiffs for the first time forwarded the argument that Omnitrition, at the silver, gold and diamond levels, fails the Nguyen test. However, given that supervisors at these levels are rewarded solely on the retail sales volume of their downline, these supervisors' rewards are directly related to the sale of products. Thus, Omnitrition meets the Nguyen standard. Moreover, in order to maintain one's position as a supervisor, in addition to maintaining a downline, one must also continue to make ten retail sales to ten customers per month (Lambert Decl.Ex. A, at 12-13).

FN3. Defendants cite further support for this position by providing the deposition testimony of named plaintiff Shawn Webster: Question: ... You understood at all times that if no retail sales were made by you or your downline you would receive no profit, didn't you?

Answer: Right.

* * *

Question: So it would be fair to say, wouldn't it, that Omnitrition emphasized selling products in connection with being an Omnitrition distributor or IMA?

Ms. Karpen: Asked and Answered.

Answer: Yeah. I already answered that. I mean they did emphasize that. They emphasized--

By Mr. Missing:

Question: And it was an essential part of being an Omnitrition IMA, wasn't it?

Answer: Yes.

(Declaration of James E. Burns, Jr. in Supp. of Defs.' Mot. for Summ. J or, Alternatively, Summ. Adjudication [Burns Decl.], Ex. N at 191-192).

FN4. It is important to note that the FTC in Amway did not hold that the safeguards would insure retail sales; rather, the FTC found the safeguards significant because they would encourage retail sales. Plaintiffs offer no evidence that Omnitrition's safeguards fail to encourage retail sales.

FN5. As is more thoroughly discussed in the Court's Order of July 6, 1994 denying plaintiffs' motion for reconsideration of the Order striking Dr. Simonson's declaration and order to show cause re: sanctions, the Court had several serious concerns regarding the circumstances surrounding plaintiffs' submission of this declaration.

FN6. Dr. Simonson allegedly also testified that Omnitrition was incapable of making retail sales because its products were of little value. Dr. Simonson allegedly relied upon the Declaration of Dr. Judith S. Stern, a professor of nutrition and internal medicine at the University of California at Davis. (Alleged Simonson Decl. ¶ 6, 9) However, several individuals who purchased these products have testified that they were beneficial, including both named plaintiffs in this action, Shawn Webster and Robert Ligon. (Burns Decl.Ex. N, 79-83; Ex. J, 82-87) Moreover, Dr. Simonson contradicts his position by testifying elsewhere in the declaration that several companies have successfully sold these products. (Alleged Simonson Decl. ¶ 10).

FN7. Defendants object to this entire section of the declaration, maintaining that it is without foundation and is an improper opinion. The Court concurs. Plaintiffs have failed to identify the person who performed the analysis and the source or basis of his or her information; nor have they provided information concerning his or her qualifications, experience, and training. Thus there is no way for the Court to determine the appropriateness of the procedures employed, the validity of the assumptions

made or reasonableness or competency of the resulting conclusions. Were the Court to consider Dr. Simonson's declaration, defendants' objection would have been sustained.

FN8. However, at other points in the declaration, Dr. Simonson suggests that Omnitrition's sales are the result of inventory loading by participants attempting to earn overrides and bonuses from sales from their downlines. (Alleged Simonson Decl. ¶ 9) Plaintiffs draw a similar conclusion in their motion papers. (Pl.s' Opp'n to Def.s' Mot. for Summ.J. at 6) In support of this assertion, both Dr. Simonson and plaintiffs refer to statements allegedly made by defendant Jerry Rubin that suggest that Omnitrition's products are merely a "hook" to luring people into the system. (Alleged Simonson Decl. ¶ 9; Pl.s' Opp'n to Def.s' Mot. for Summ.J. at 6.) Plaintiffs cite to a document attached to the Declaration of Andrew Lamis in support of this position. (Decl. of Andrew P. Lamis in Opp'n to Defs.' Mot. for Summ.J. Ex. R.) However, as defendants point out, this statement is not located in the document attached to the Lamis Declaration. (See Def.s' Reply Mem. in Supp. of Mot. for Summ.J. at 17 n. 16). Moreover, defendants' objection to this document, on the ground that it has not been properly authenticated, is sustained. See Zosko v. MCA Distributing Co., 693 F.2d 870 (9th Cir.1982), cert. denied 460 U.S. 1085 (1985).

FN9. At the hearing, the parties noted that Omnitrition generates several thousand Form 1025s in a month.

FN10. Dr. Simonson allegedly testified that a distributor's lack of incentive to submit Form 1025s is evidence that these forms do not encourage retail sales. (Alleged Simonson Decl. ¶ 25, at 21). This argument is unpersuasive. It is not readily apparent what incentive a distributor would have to make non-retail sales or engage in inventory loading, since a distributor cannot obtain bonuses or overrides from the sales related to his or her downline. (Lambert Decl. ¶ 12, Ex. A, 12-13)

FN11. Plaintiffs challenges to Omnitrition's 70% rule and buyback/refund rule are also deficient, in that they are without any competent or admissible evidentiary support.

FN12. Plaintiffs' counter-motion for summary adjudication of certain issues is directed solely to the issue of whether Omnitrition falls within the legal definition of an illegal pyramid sales scheme. Accordingly, the counter-motion is denied.

FN13. Thus, defendants' statements that Omnitrition is not an illegal pyramid scheme are also not actionable as misstatements of fact, since defendants' statements are technically correct.

FN14. Plaintiffs submit evidence which demonstrates that a relative minority of Omnitrition distributors made significant amounts of money through participating in the company. (Decl. of Andrew P. Lamis in Opp'n to Defs.' Mot. for Summ.J. Filed Under Seal). However, plaintiffs fail to identify any statements by the defendants in which claims are made concerning the likelihood of making significant amounts of money in Omnitrition. Moreover, it is not readily apparent how the income structure of Omnitrition, and the claims about its success, are different from any other company transacting business consistent with the security laws.

FN15. Defendants also challenge plaintiffs' allegations that defendants made actionable omissions of fact. Plaintiffs allege, in paragraph 48 of the amended complaint, that defendants have failed to disclose that Omnitrition is a pyramid scheme, or that defendant failed to disclose their prior association with another network marketing company, Herbalife. Plaintiffs do not address either of these arguments.

The first alleged omission is clearly not actionable, since, as previously mentioned, Omnitrition does not fall within the legal definition of a pyramid scheme. Plaintiffs have failed to explain the relevance of the second alleged omission, and have not forwarded any evidence that this information was hidden or undisclosed. Moreover, a nondisclosure can be actionable only if it renders an affirmative statement misleading. Alfus v. Pyramid Technology, 745 F.Supp. 1511, 1518-19 (N.D.Cal.1990). Plaintiffs have not identified any statement or fact which would require disclosure of defendants' association with Herbalife.

FN16. Moreover, it is important to note that the Court is not obligated to consider matters not specifically brought to its attention. See Schwarzer, Tashima & Wagstaffe, Cal.Prac. Guide: Fed.Civ.Pro. Before Trial § 14.145.2 (The Rutter Group 1993). The opposition to a summary judgment motion must designate and reference specific triable facts. Frito-Lay v. Willoughby, 863 F.2d 1029, 1034 (D.C.Cir.1988) ("failure to designate and reference triable facts was, in light of the language of Rule 56(c) and governing precedent, fatal to its opposition."); Nissho-Iwai Am. Corp. v. Kline, 845 F.2d 1300, 1307 (5th Cir.1988) (rejecting notion that "the entire record must be searched and found bereft of a genuine issue of material fact before summary judgment may be properly entered.")

FN17. At the hearing, plaintiffs suggested that Shawn Webster testified at his deposition that he lost approximately $700.00 through participating in Omnitrition. Plaintiffs failed to identify where this testimony was located. However, a review of Shawn Webster's deposition testimony demonstrates that plaintiffs are incorrect. Nowhere did Shawn Webster testify that he lost any money through participating in Omnitrition.

FN18. Plaintiff Robert Ligon insists that he lost money, but, tellingly, has yet to forward any evidence concerning the nature or extent of any such loss. (Burns Decl. Ex J, at 324).

FN19. Plaintiffs maintain that defendants Gardere & Wynne and M. Douglas Adkins engaged in some legitimate activity while participating in Omnitrition; however, since they were not named in the association in fact, their actions are not relevant for consideration of this issue.